

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0732
Gross Income Tax – Scientific Equipment Sales
For Tax Periods: 1993 through 1996

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ISSUE

Gross Income Tax — Scientific Equipment Sales

Authority: IC 6-8.1-5-1(b); 6-2.1-2-2; 6-2.1-3-3; 45 IAC 1-1-120; *Standard Pressed Steel Co. v. Dept. of Revenue of Washington*, 419 U.S. 560 (1975).

The taxpayer protests the inclusion of its scientific equipment sales in its Low Rate Gross Receipts.

STATEMENT OF FACTS

The taxpayer is a foreign corporation that sells blood gas analyzers and metallographic equipment. Medical facilities purchase the blood analyzers for conducting blood tests, and metal manufacturers purchase the metallographic equipment for use in the quality control process. The taxpayer also sells extended maintenance agreements whereby customers receive maintenance and repairs on equipment purchased. According to the taxpayer's Extended Maintenance Protection Agreement, maintenance and repairs are performed at the customer's business location whenever possible.

The taxpayer employs four employees in Indiana, all of whom work out of their residences. These employees variously facilitate the sale, installation, on-site training and warranty provisions of equipment sold. Three of the employees serve as service and repair representatives. Taxpayer's product brochure provides telephone and facsimile numbers for a "field sales office" purportedly in Indiana.

The Department audited taxpayer's business income for tax years 1993-1996. A deficiency was determined based upon the taxpayer's omission of its equipment sales in its Low Rate Gross Receipts. Taxpayer protested the assessment, and the Department held a hearing on June 17, 1998. Additional facts appear below as necessary.

DISCUSSION

A notice of proposed assessment constitutes prima facie evidence that the Department's claim for unpaid tax is valid. IND. CODE § 6-8.1-5-1(b). The person against whom the proposed assessment is made has the burden of proof that the assessment is wrong. *Id.*

The taxpayer in the instant case advances two main reasons for excluding its Indiana equipment sales from gross income tax. First, it argues that the equipment sales represent sales in interstate commerce. In support of this argument, the taxpayer alleges that its Indiana sales representatives "merely solicit sales" and that all shipping, approvals of orders and customer credit checks take place at or from its corporate headquarters outside of Indiana. (Letter from Taxpayer to Department of 12/18/97 at 1.) Second, the taxpayer states that a prior corporate income tax audit by the Department determined that the aforementioned argument and allegation were "bonafide." *Id.* These arguments will be addressed in turn.

(1) Interstate Commerce Exemption

Indiana Code 6-2.1-2-2 imposes a gross income tax on the gross receipts from a trade or business unless the receipt of gross income qualifies for an interstate commerce exemption. "Business conducted in interstate commerce between the state of Indiana and either another state or a foreign country is exempt from gross income . . ." IC 6-2.1-3-3.

During the audit period the Department had codified its gross income tax regulation on the interstate sale of goods to Indiana buyers at 45 IAC §1-1-120 (1988) (current version at 45 IAC § 1.1-3-3 (1999)), which read in relevant part as follows:

Sec. 120. Sales of Goods Originating in Other States to Persons in Indiana. As a general rule, income derived from sales made by nonresident sellers to Indiana buyers is not subject to gross income tax unless the seller was engaged in business activity within the State and such activity was connected with or facilitated the sales. Local activity sufficient to subject the seller to taxation may result . . . from the nature and extent of his business activities in the State.

The regulation goes on to provide the following examples of taxable in-shippments:

(2)(a) Sales made by a nonresident, when the seller has established a business situs within the State, and the sales originated from, were channeled through or were otherwise connected with the Indiana situs. Depending on the fact situation, a business situs may be an *office . . . business address, residence used for business purposes, business telephone, or any other kind of fixed establishment identified with the seller's business.*

* * * *

(c) Sales made by nonresidents where the goods are shipped directly to the buyer from an out-of-state business location, but where the seller is conducting *substantial business activities within the State which were connected with the sales.*

- (c) Sales made by a nonresident where the goods are shipped by the seller directly from an out-of-state location to the buyers, but where the seller had an *employee or employees working within the State who were responsible for maintaining valuable and long-lasting contractual relations between seller and buyer, from which relations the sales arose.*

45 IAC §1-1-120 (*emphasis added*).

Information provided in the Audit report and by the taxpayer evidences the establishment of an Indiana situs to which equipment sales are connected. First of all, the taxpayer, through use of its Indiana employees' residences, uses several fixed establishments for its Indiana equipment business. Moreover the taxpayer advertises on its brochure an Indiana business telephone number, designated as that of an Indiana "Field Sales Office," which customers may—and likely, do—use to conduct business with an Indiana field representative. As a result, the taxpayer's use and advertising of these facilities for its Indiana employees' business activities establishes a presence in Indiana which mirrors circumstances described in Rule 45 IAC 1-1-120(2)(a). Because these activities fall within the ambit of this rule, the taxpayer's equipment sales facilitated in part through them are subject to gross income tax.

The business activities of taxpayer's Indiana employees themselves further establish Indiana situs and tax liability. Contrary to taxpayer's assertion that its Indiana employees "merely solicit sales," they in fact perform other necessary services once equipment sold is delivered to Indiana buyers. Specific post-delivery duties of these employees variously include installation, training, maintenance, and warranty work on the equipment, usually at the buyer's place of business. These activities, which are directly connected with and are performed as a result of the sale, clearly constitute the performance of services in Indiana. As such, they fall within the ambit of 45 IAC § 1-1-120(2)(b) and subject the taxpayer's equipment sales income to gross income tax.

Lastly, Taxpayer's Indiana activities fall within the ambit of Rule 45 IAC 1-1-120(2)(c). In *Standard Pressed Steel Co. v. Dept. of Revenue of Washington*, 419 U.S. 560 (1974), the United States Supreme Court evaluated a single resident employee's customer relations activities in light of a similar rule. Operating out of his home, the employee primarily consulted with customers on their anticipated equipment needs and requirements, and followed up on difficulties clients encountered with equipment already delivered. 419 U.S. at 561. He at no time took orders for his employer. *Id.* Considering whether these in-state activities created income tax liability for the out-of-state employer, the Court focused on the connection between those activities and the sales realized. 419 U.S. at 564. The Court held that the employee, "with a full-time job within the State, made possible the realization and continuance of valuable contractual relations" between his out-of-state employer and an in-state customer. 419 U.S. at 562-63. Taxation, the Court reasoned, may be thus justified where the providence of such services is "substantial 'with relation to the establishment and maintenance of sales, upon which the tax was measured . . .'" 419 U.S. at 563 (quoting *General Motors Corp. v. Washington*, 377 U.S. 436, 447 (1964)).

It is the Department's position that Taxpayer's Indiana employee activities are similarly substantial in relation to the equipment sales upon which taxpayer's tax liability is based. While it may be true that taxpayer's Indiana employees do not approve sales, they do perform a variety of other activities within Indiana and directly connected with Indiana equipment sales. In effect,

these activities both establish and maintain taxpayer's Indiana income from equipment sales. This income is, therefore, subject to Indiana gross income tax.

(2) Treatment of Prior Audits

The taxpayer sets out a general equitable argument—unsupported by citations to statutory or regulatory authority—that the treatment of taxpayer's sales activities in pre-1992 audits preclude the Department from assessing tax on sales activities in 1992-1994 audits.

Specifically, the taxpayer argues that it is entitled to rely upon the fact that a prior corporate income tax audit by the Department “determined that reason's [sic] number 1 and 2 listed above were bonafide.” (Letter from Taxpayer to Department of 12/18/97 at 1). By “reasons 1 and 2” the taxpayer means that its “equipment sales represent sales in interstate commerce” and that its “Indiana sales representatives merely solicit sales,” with shipping, order approvals and customer creditworthiness taking place outside of Indiana.” *Id.*

Conclusions reached in prior audits about the nature or extent of a taxpayer's Indiana business activities may not, however, be used to estop the Department from reaching different conclusions in subsequent audit periods based on facts ascertained during that period. The Department considers each audit period separately, based upon the particular facts and circumstances contained therein. Absent evidence of factual similarities between taxpayer's pre-1992 commercial activities and those between 1992 and 1996, the Department finds the taxpayer's assertion unpersuasive.

FINDING

Taxpayer's protest is respectfully denied.